

XX CONFERENCIA ANUAL DE ESTUDIOS ECONÓMICOS
FONDO LATINOAMERICANO DE RESERVAS (FLAR),

MONETARY POLICYMAKING IN A CONTEXT OF EXTREME UNCERTAINTY

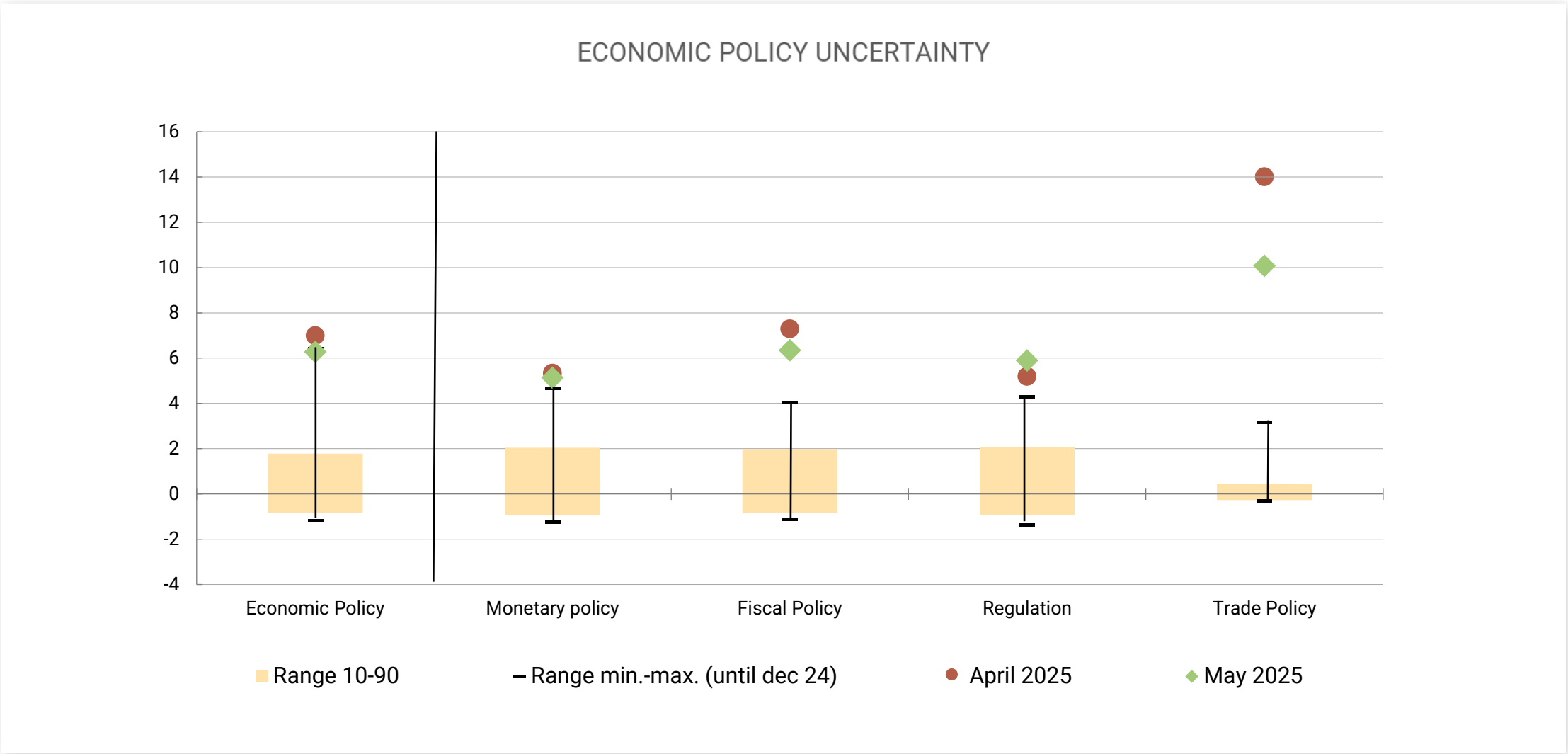
JOSÉ LUIS ESCRIVÁ

GOVERNOR OF THE BANCO DE ESPAÑA

13 JUNE 2025

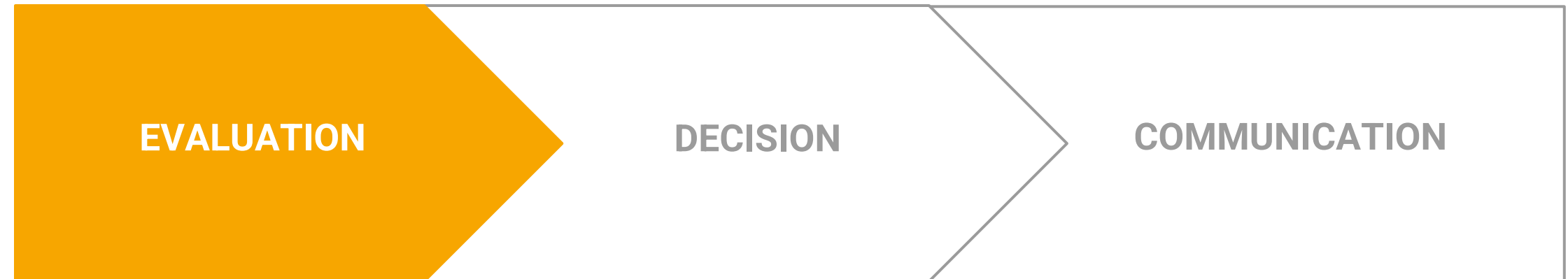


A CONTEXT OF VERY HIGH UNCERTAINTY IN MULTIPLE DIMENSIONS: TRADE, FISCAL, MONETARY AND REGULATORY



Sources: US Economic Policy Uncertainty Index – Categorical classification. https://www.policyuncertainty.com/categorical_epu.html

THREE KEY IMPLICATIONS FOR MONETARY POLICY



UNDER HIGH UNCERTAINTY, THE USE OF ALTERNATIVE SCENARIOS AND HIGH-FREQUENCY DATA GAINS RELEVANCE

- THE **CENTRAL SCENARIO BECOMES LESS INFORMATIVE** AND THE USE OF ALTERNATIVE SCENARIOS TO BETTER ASSESS THE BALANCE OF RISKS GAINS RELEVANCE



- IT RAISES THE **IMPORTANCE OF MONITORING HIGH-FREQUENCY DATA**
EXAMPLE: USE OF HIGH FREQUENCY DATA DURING THE VALENCIA FLOODS (29-OCT-2024)

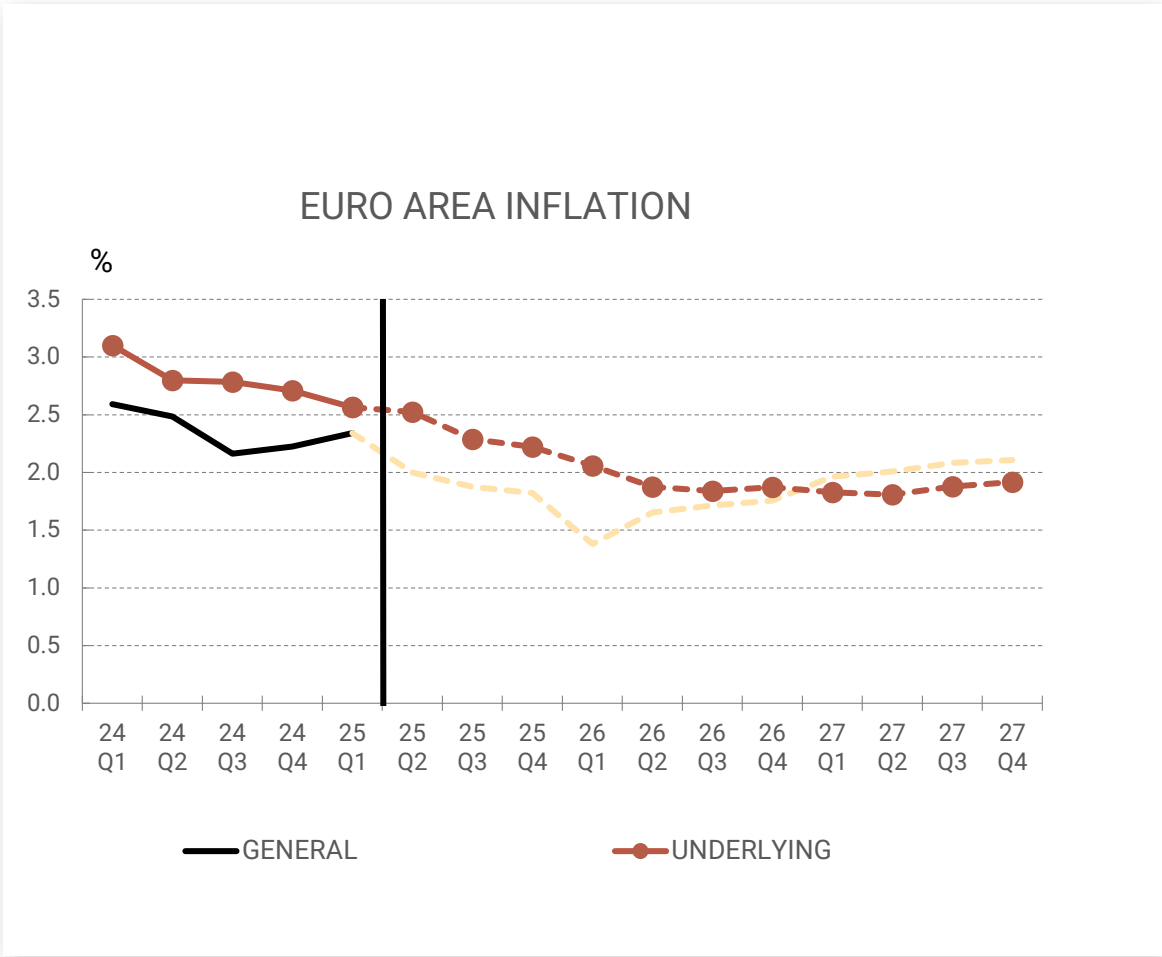
THE ANALYSIS OF ALTERNATIVE SCENARIOS ENHANCES THE ROBUSTNESS AND TRANSPARENCY OF MONETARY POLICY

Fosters robustness of monetary policy plans in the face of uncertainty about the state and structure of the economy

Improves the ability of the public to anticipate how policymakers will respond to various contingencies

Source: Bank of England Bernanke's review (2024).

ILLUSTRATION: THE ECB JUNE PROJECTIONS INCLUDE A BASELINE SCENARIO, WITH SLIGHT DOWNWARD REVISIONS TO GROWTH AND INFLATION, BUT ALTERNATIVE SCENARIOS ARE ALSO PUBLISHED...



ECB MACROECONOMIC PROJECTIONS FOR THE EURO AREA				
	JUNE 25		REVISION WITH RESPECT TO MARCH 25	
	2025	2026	2025	2026
GDP	0.9	1.2	0	-0,1
INFLATION	2.3	1.9	-0,3	-0,3
UNDERLYING INFLATION	2.2	2.0	+0,2	-0,1

Alternative scenarios: lower GDP growth and lower inflation

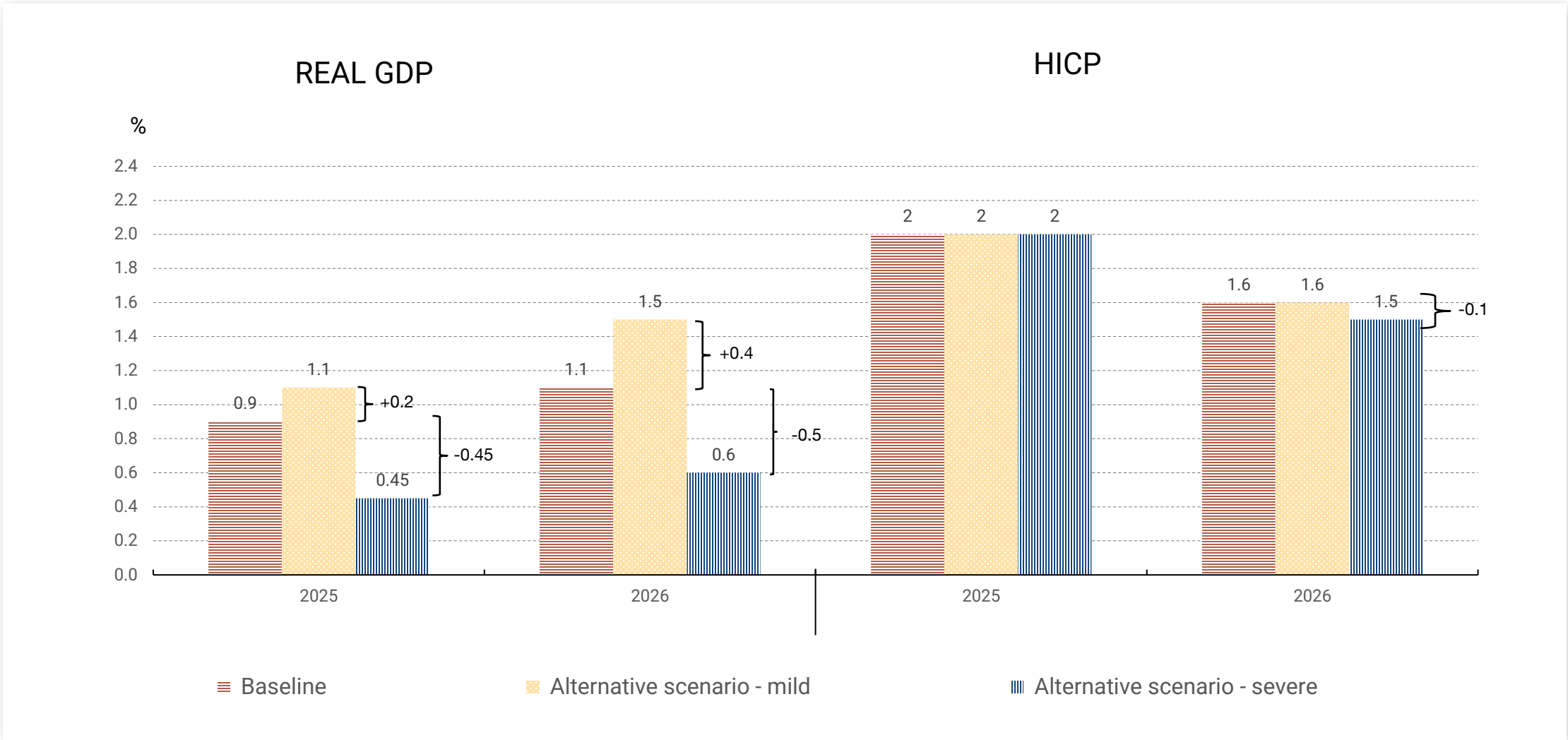
Sources: March 2025 – Macroeconomic Projections Exercise June 2025 – Broad Macroeconomic Projections Exercise. European Central Bank.

THE MILD SCENARIO ASSUMES A DEAL BETWEEN THE EU AND THE US TO ELIMINATE BILATERAL TARIFFS, WHILE THE SEVERE SCENARIO REFLECTS A PROLONGED ESCALATION IN TRADE TENSIONS

Additional tariffs on(*):	Mild	Baseline	Severe
EU	0%	10%	tariffs announced on 2 April with retaliation
China	Lower tariffs, no retaliation	20% with retaliation	tariffs announced on 2 April with retaliation (up to 120%)
Rest of world	0%	10%	higher tariffs with retaliation
Uncertainty	gradual reduction to pre-2018 average in 2027	remains elevated but gradual reduction to 2018 average in 2027	remains persistently high
(*) with respect to the situation in place before 2 April			

Sources: June 2025 – Broad Macroeconomic Projections Exercise. European Central Bank.

A MILD RESOLUTION WOULD SLIGHTLY LIFT GROWTH, WHILE A TARIFF ESCALATION WOULD DAMPEN EURO AREA ACTIVITY, WITH LIMITED DEFLATIONARY IMPACT

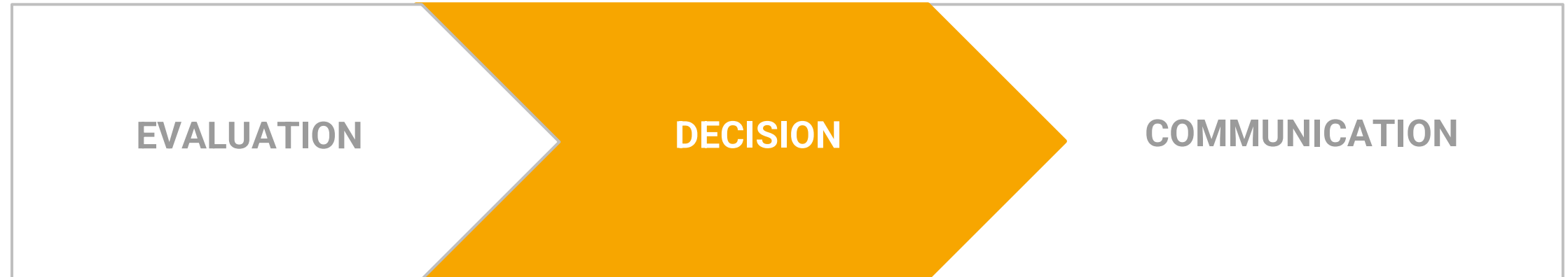


Sources: June 2025 – Broad Macroeconomic Projections Exercise. European Central Bank.

CERTAIN FACTORS/CHANNELS ARE MORE DIFFICULT TO INCORPORATE INTO SCENARIOS.
IN THE CURRENT CONTEXT, THIS MAY AFFECT THE BALANCE OF RISKS FOR INFLATION.

CHANNELS INCLUDED		CHANNELS NOT INCLUDED	
EFFECT ON EURO AREA INFLATION		EFFECT ON EURO AREA INFLATION	
US tariffs on trade	↓ ↑	Generalized increase in tariff/non-tariff measures, may be very disruptive for global value chains and create bottlenecks	↑ ↑
Uncertainty & Financial turmoil on domestic demand & energy prices	↓ ↓		
EMU retaliation on trade	↑	Difficult to model and to find a historical benchmark to calibrate	
SCENARIO: MILDLY INFLATIONARY		POTENTIALLY RELEVANT INFLATIONARY CHANNELS MAY BE MISSING	

IMPLICATIONS FOR MONETARY POLICY



IN THIS CONTEXT, WHILE PRESERVING A DATA-DEPENDENT AND FULL-OPTIONALITY APPROACH, MONETARY POLICY SHOULD BE CAUTIOUS BUT AGILE

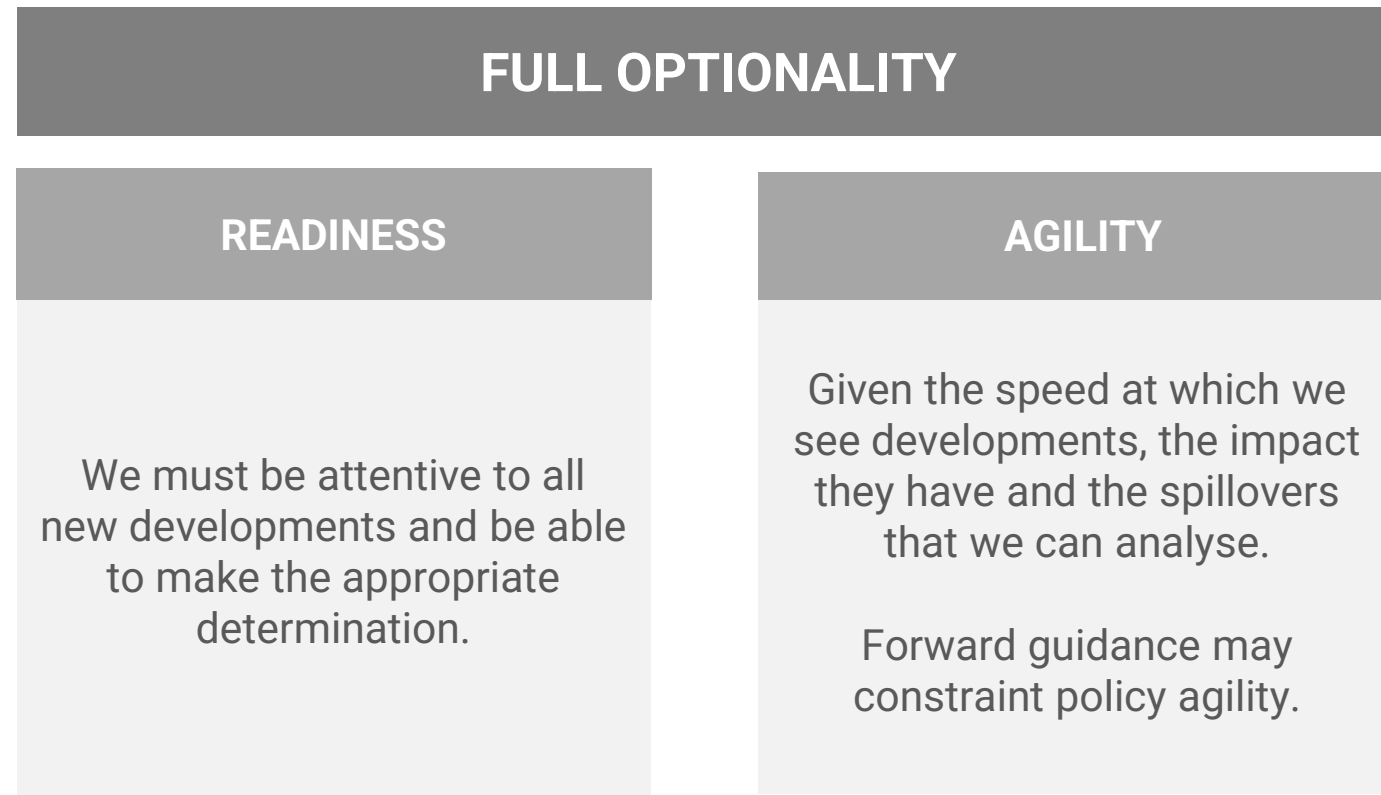
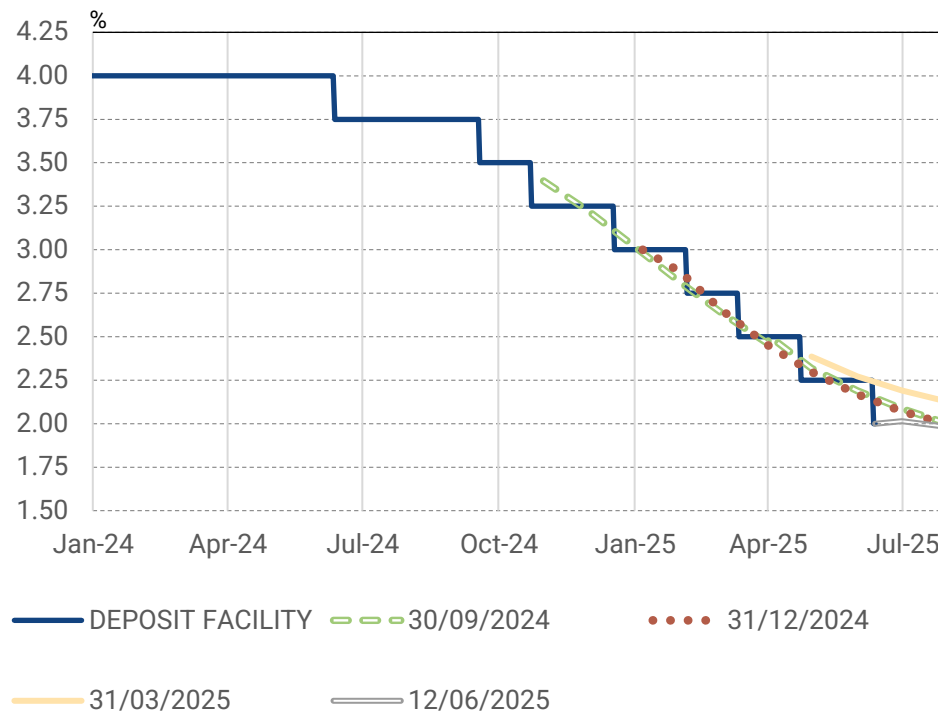


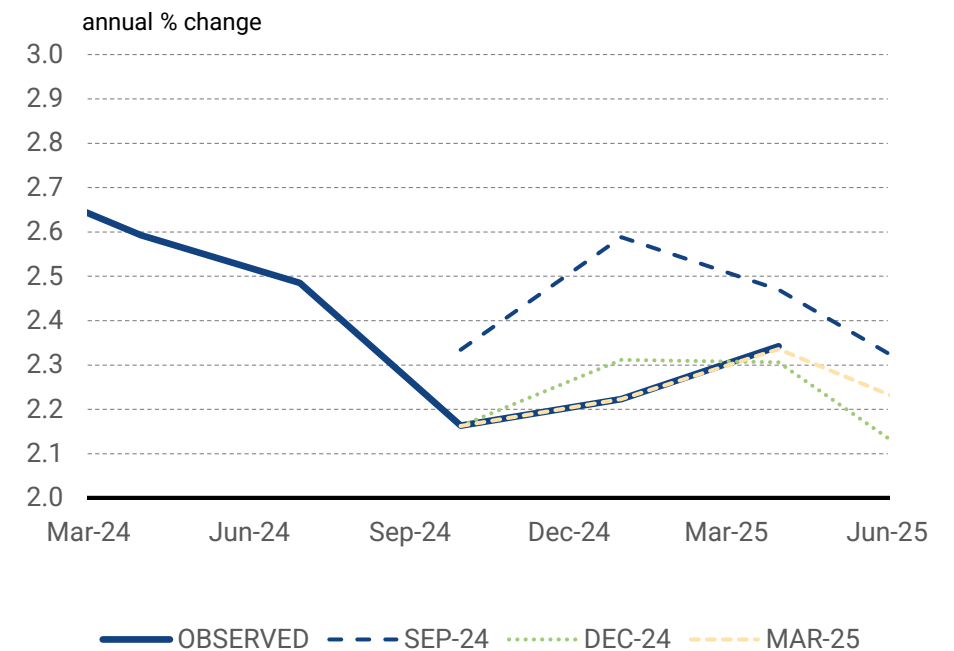
ILLUSTRATION: THE PROCESS OF ECB RATE CUTS HAS BEEN CONSISTENT WITH THE GRADUAL REALIZATION OF THE PROJECTED CENTRAL INFLATION SCENARIO.

- Decisions have been taken **with no forward guidance**:
- Instead, a “**full optionality**” strategy has been adopted meeting by meeting under a **two-sided risk** environment.

ECB DFR AND MARKET-BASED EXPECTATIONS

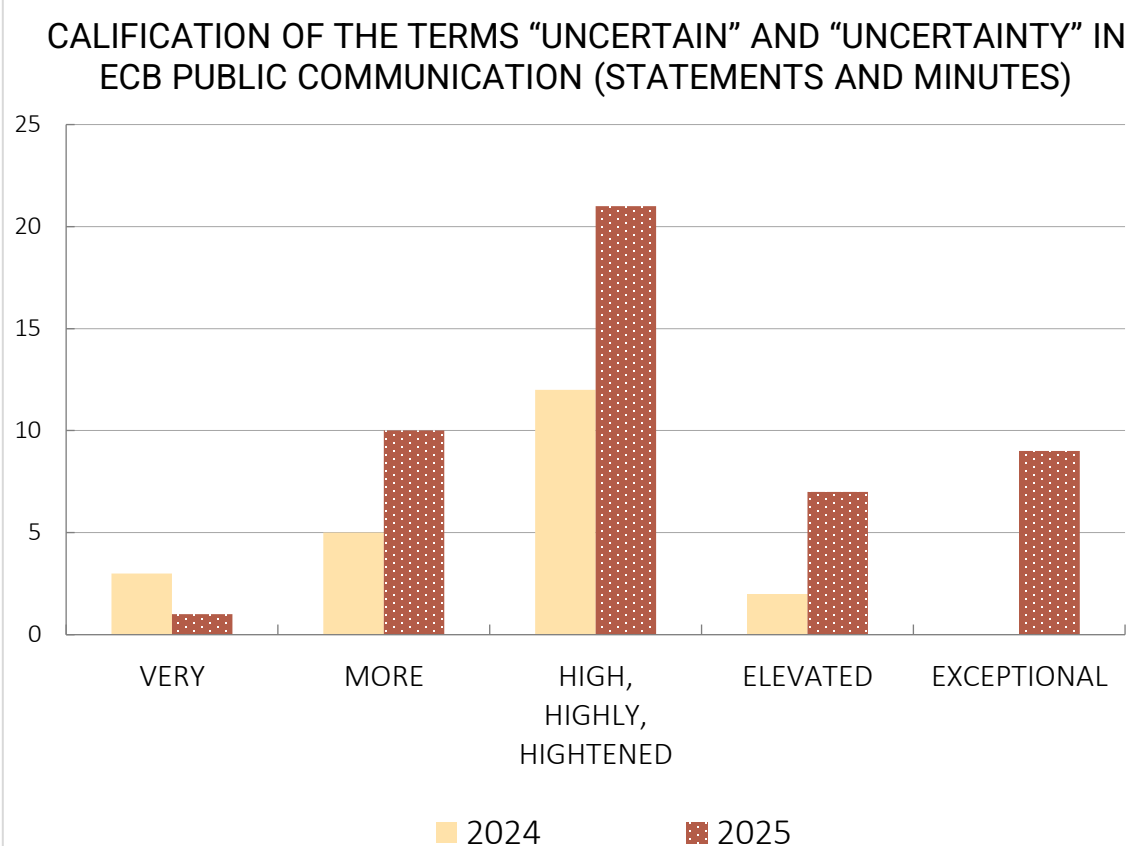
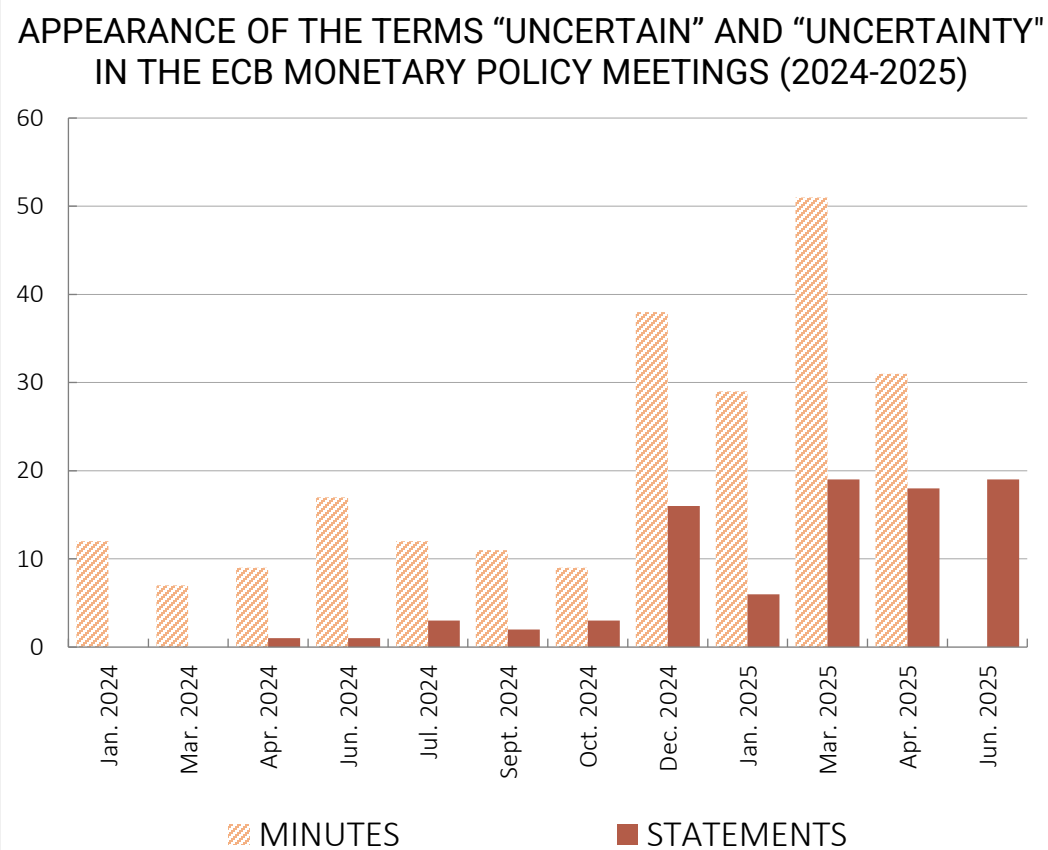


EA HICP: OBSERVED AND (B)MPE FORECASTS



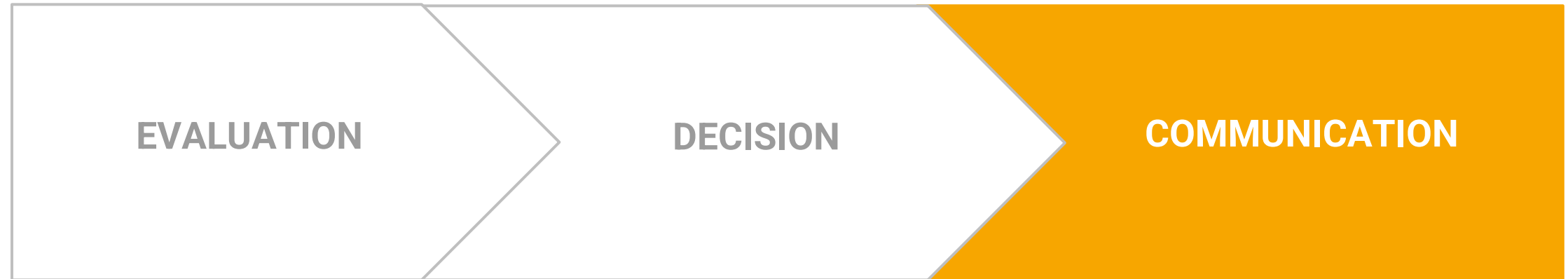
Source: Bloomberg Data License

AS AN EXPLICIT MANIFESTATION OF SUCH FLEXIBLE DECISION-MAKING, THE UNCERTAINTY LABELING HAS EVOLVED: "HIGH", "VERY HIGH", "ELEVATED", "EXCEPTIONAL".



Source: European Central Bank.

THREE KEY IMPLICATIONS FOR MONETARY POLICY



HOW ARE CENTRAL BANKS DEALING WITH THE CHALLENGE OF COMMUNICATING MONETARY POLICY INFORMATION UNDER A CONTEXT OF VERY HIGH UNCERTAINTY?

BANK OF ENGLAND

- Bernanke review on the BoE's policymaking and communication during times of significant uncertainty.
- Since 2024, the Monetary Policy Report (non-regularly) includes alternative scenarios ("cases").
- Those published are "merely examples of a wide range of different paths the economy could take."

RIKSBANK

- Since 2007, publication of macroeconomic projections including interest rate paths.
- The forecast for the policy rate shows the Executive Board's assessment in the coming three quarters.

US FEDERAL RESERVE

- The quarterly economic projections include assessment of uncertainty and risks around their forecasts.
- These reflect both historical forecast errors and FOMC participants' current judgements.

ECB

- Alternative scenarios have exceptionally been included in the staff Macroeconomic Projections Exercise.
- Only in the context of very specific risks (Covid, Ukraine war, Middle East tensions, US tariff policies...).

ONE OPTION TO EXPLORE IMPLIES PUBLISHING ALTERNATIVE SCENARIOS

FOR:

- Transparency
- Conveys additional information on the central bank reaction function

AGAINST:

- Complexity
- Difficulty to communicate alongside the baseline scenario
- Risk of misinterpretation as state-contingent commitments

THANK YOU FOR YOUR ATTENTION
